

IN THE CHANCERY COURT FOR WILLIAMSON COUNTY, TENNESSEE
TWENTY-FIRST JUDICIAL DISTRICT AT FRANKLIN

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WILLIAMSON COUNTY
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STATE OF TENNESSEE, *ex rel.*
ROBERT E. COOPER, JR., ATTORNEY
GENERAL and REPORTER,

Plaintiff,

v.

ROLAND FROEHLIG, a.k.a. Rollie Froehlig,
THEODORE HOWES, a.k.a. Ted Howes,
NATIONAL FULFILLMENT, INC., and
ENTERTAINMENT AMERICA, INC.,

Defendants.

No. 33293

JURY DEMAND

MEMORANDUM IN SUPPORT OF MOTION FOR APPOINTMENT OF RECEIVER
AS TO CORPORATE DEFENDANTS

Both circuit and chancery courts are vested with the power to appoint receivers “for the safekeeping, collection, management, and disposition of property in litigation in such court . . . whenever necessary to the ends of substantial justice . . .” Tenn. Code Ann. § 29-1-103.

A receivership is traditionally an equitable proceeding over which the Chancery Court exercises substantial discretionary authority. *In re Liquidation of United American Bank*, 743 S.W.2d 911, 916 (Tenn. 1987).

Under the Identity Theft Deterrence Act and the Tennessee Consumer Protection Act, courts are likewise given broad discretion to “issue any other necessary or appropriate relief or orders.” See, e.g. Tenn. Code Ann. § 47-18-2105(c). Tenn. Code Ann. § 47-18-108(b)(1). The Attorney General also has broad common law authority and has moved for receiverships in similar cases in the past.

Traditionally, appointment of a receiver has been approved when necessary “for the purpose of preserving the property in controversy, pending the litigation, for the benefit of the successful party.” *In re Armstrong Glass Company, Inc.*, 502 F.2d 159, 163 (6th Cir. 1974)(quoting from *Johnston v. Hanner*, 70 Tenn. 8, 11 (1878); *Roberson v. Roberson*, 71 Tenn. 50, 52 (1879). Here, the parties have begun to liquidate assets of the company and stand to receive sizeable incoming assets as a result of Mr. Froehlig’s death.

GIBSON’S SUITS IN CHANCERY recognizes seven separate, non-exclusive considerations that weigh in favor of the application of a Receivership including:

1. That the defendant has been guilty of fraudulent or other inequitable conduct, jeopardizing plaintiff’s rights.
2. That the defendant is insolvent, and is enjoying the property or its proceeds.
3. That the defendant has not properly maintained the property, or has mismanaged or misused it, or has displayed incapacity or indifference, jeopardizing plaintiff’s rights.
4. That the defendant has failed to pay the taxes, or to keep the property duly insured when insurance is expedient, or stipulated.
5. That the parties interested are numerous, and not one of them has any particular right to the possession of the property.
6. That the property is charged with a trust, and the trustee’s conduct is questionable.
7. That a receivership can do no one any particular harm, and may be of great benefit to those entitled to the property, or its proceeds.

GIBSON’S SUITS IN CHANCERY § 24.12 (8th ed. 2004).

The first consideration is applicable and mitigates in favor of granting the State’s request for a receivership. Here, while no final adjudication has been made as to the State’s identity theft and consumer protection act claim, this Court in its March 2nd, 2007 Order has found that the State has a “substantial likelihood of success on the merits” of its identity theft action against the corporate Defendants and individual Defendants. While \$300,000 was placed in a registry account with the Williamson County Clerk and Master pursuant to an asset freeze, the State stands to be a substantial creditor of both companies now apparently defunct. The liquidation of

assets of the company stands to jeopardize the State's rights of recovery should any monetary relief be awarded.

The second, third, fourth, and fifth considerations are also applicable and mitigate in favor of granting a receivership. As evidenced by the action in Wilson County in which the lessor for National Fulfillment's warehouse obtained a permanent injunction directing payment of life insurance proceeds into the Wilson County Clerk and Master's office to pay, among other things, approximately \$150,000 in past-due rent and unpaid property taxes, the company has recently been in a precarious financial position. Liquidation of the company's assets at this point with the emergence and likely emergence of many creditors, including the State, former clients, unsecured and secured creditors at best displays an indifference to the State's position, consumer victims, and those of other unsecured creditors. It is also unclear what capacity Ted Howes, who is believed to be liquidating the company, is operating under given that, at least under Mr. Froehlig's September 17, 2007 Will, Mrs. Froehlig is a majority shareholder of both companies. While certain secured creditors may have a priority for the liquidation of certain assets, among unsecured creditors, such as the State and many other former clients not one of the unsecured creditors has any particular right at this moment to the possession of the unsecured assets of the company, including some life insurance proceeds or portions of life insurance proceeds, to the State's knowledge. It should be noted that no creditor possesses rights to the actual proceeds of the identity theft, save for the victims themselves.

The seventh consideration is applicable and also mitigates in favor of granting the State's motion for a receiver. A receiver who independently assesses the assets and liabilities of the company and determines whether the company is viable or whether it should be liquidated, poses no harm to the company when it has already begun to liquidate assets. A receivership

would have the benefit of allowing for the orderly and fair disbursement of the assets of the company. Moreover, an independent receiver would be able to determine whether the company itself would have any causes of action against directors for potential violations of their fiduciary obligations, the recovery of which could conceivably allow the business to continue to operate as a going concern.

GIBSON'S SUITS IN CHANCERY also lists factors that would weigh against the granting of a receivership. These factors include:

1. That the plaintiff has been guilty of *laches*, or inequitable conduct.
2. That the plaintiff is not clear and emphatic in the allegation of his equities.
3. That the appointment is likely to harm the defendant, while the advantages to the plaintiff will be comparatively small.
4. That the benefits of a receiver are likely to be counterbalanced by the trouble, expenses, or losses that will probably result from the appointment.
5. That there is no urgency, and an appointment would produce no benefits, even if the defendant would not be particularly harmed thereby.
6. That the defendant is willing to comply with all orders necessary to secure the rights of the plaintiff, and to preserve the property, or fund, or its proceeds, and is able and willing to give bond therefor.

The Chancellor will furthermore consider whether upon a view of the whole case there is a probability that the plaintiff will be entitled to recover, or that he will be harmed if the defendant is allowed to retain the possession of the property.

GIBSON'S SUITS IN CHANCERY § 24.12 (8th ed. 2004).

None of these factors are applicable to the present case. The State has not been guilty of *laches*. The State was notified that the Defendants were liquidating their assets mid-week and filed its receivership motion the first thing Friday morning. The State comes to the suit as a civil law enforcement entity with clean hands and with the intention of protecting consumers victims from across the country and within the State. The State has been clear in stating its interest in the remaining unsecured assets of the companies should the State succeed in its action.

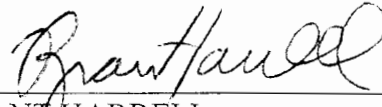
The third, fourth, and fifth consideration are also not applicable. The appointment of a receiver is not likely to harm the Corporate Defendants. The Corporate Defendants, on their own

initiative, are already in the process of being liquidated. The appointment of an independent and impartial receiver can only help Corporate Defendants. If the receiver decides that it is in the company's best interest to liquidate, that liquidation can proceed in an organized and orderly manner under the supervision of this Court. If the receiver decides that it is in the company's best interest to continue the business, then this by itself is a better position than the Corporate Defendants presently find themselves in. It is the absence of the appointment of a receiver in this case rather than its presence that would lead to trouble, confusion, expenses or losses for creditors and potential creditors of the Defendants. While certainly the receiver will incur expenses in executing his duties, this alone is not enough to counterbalance the trouble, confusion, expenses or losses for creditors or potential creditors in chasing dissipated assets. While at the present time, we do not know whether the Corporate Defendants are willing to comply with all orders necessary to secure the rights of plaintiffs and to preserve property, the Corporate Defendants in the past, when they were on less precarious financial ground at the February 28, 2007 Temporary Injunction Hearing, dismissed the idea of substituting a bond in lieu of an asset freeze outright. It does not seem likely that they would do so now when their financial position appears more dire.

This Court has previously considered the probability that the Plaintiff, the State, will be entitled to recover under its identity theft action. In its March 2nd, 2007 Order Granting the Temporary Injunction, this Court found that the State has shown a "substantial likelihood of success on the merits" of its identity theft action.

For all of the above reasons, the State argues that a Receiver should be immediately granted over the Corporate Defendants consistent with the State's Motion.

Respectfully submitted by:



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CERTIFICATE OF SERVICE

I, Brant Harrell, do hereby certify that the foregoing document was sent via
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On this the 19th day of October, 2007



BRANT HARRELL
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